In the Court of Appeals of the State of New York.

CHARLES CLAFLIN *et al. vs.* THE FARMERS' AND CITIZENS' BANK OF LONG ISLAND.[1]

1. An agent of a bank who, in general terms, is authorized by a by-law or otherwise to certify checks drawn upon the bank, cannot certify his own checks when he has no funds to his credit, so as to make the bank liable. The rule of the law of agency is applicable, that an agent cannot put himself in a position of hostility to his principal.
2. A holder who pays value for such a check cannot be said to take it in good faith. The fact that the name of the drawer is identical with that of the certifying agent is sufficient to put him upon inquiry. The holder is bound to ascertain whether the certifying officer is using his official position to perpetrate a fraud. If such is the fact, he cannot recover from the bank.
3. Where a judge, at the circuit, on the *ex parte* application of a party to an action, irregularly refers a cause to a referee to try the whole issue, and the party who has a right to object proceeds with the trial of the action, produces evidence, and submits the case to the referee without objection, the question of the irregularity of the reference cannot be raised upon an appeal.

This action was brought to recover upon three checks drawn upon the defendants' bank and certified as *good* by their president. Two of the checks, one for $5500 and one for $10,000, were drawn by the president, G. W. Houghton, to the order of Oct. Cleveland, and the other for $5000 by Thomas Green, payable to the order of said Cleveland. The referee finds that the checks were drawn and certified at their date. The president had authority to certify checks upon the defendants' bank, that such checks were certified at his business office in New York, that such fact was not known to the plaintiffs when they received the checks. (The complaint states that the defendants' bank transacted business at Williamsburgh, in the county of Kings.) The referee further finds that the said checks at their date were delivered to the payee thereof, who at the same time paid the drawers the full amount thereof: that the payee of such checks indorsed and transferred

[1] We owe this case to the kindness of Smith, J., for which he will accept our thanks.—EDS.

the same to the plaintiffs on the day of their dates, who then paid to the said payee the full amount of said checks respectively, and that the plaintiffs so received said checks in good faith, and have ever since held the same. That they were presented for payment December 1st, 1854, at defendants' bank, and payment refused. The checks are dated, the one signed by Green, December 31st, 1853; the $5500 by Houghton, February 4th, 1854; and the $10,000 check, February 25th, 1854.

The defendant moved for a nonsuit, when plaintiffs rested. Motion denied and defendants excepted. Farther evidence was then given by defendants and plaintiffs.

As matter of law the referee found that the defendants were liable upon such checks: That the plaintiffs were entitled to judgment for $26,229 thereon.

To which report and finding of law and fact the defendants duly excepted.

The judgment of the referee was affirmed on appeal at the General Term of the first district, and defendants appealed to this Court.

By the Court:

E. DARWIN SMITH, J.—The objection that the cause was improperly referred on the ex parte application of the plaintiffs' counsel at the circuit, cannot now be raised. If there was error in the reference, the defendants should have applied to the circuit judge or at special term to vacate the order. After giving testimony before the referee and trying the cause upon the merits without objection, it is too late to raise the question in the court of revision that the action was improperly referred.

The motion for a nonsuit was properly denied. When it was made the plaintiffs had proved the making of the three checks, and the acceptance by the indorsement thereon by the defendants' president of the word *good*, and also a by-law of the defendants' which impliedly authorized the president to certify checks, and also the due presentment of the checks thereafter and the refusal of the defendants to pay the same.

This proof clearly at least entitles the plaintiffs to recover upon

the $5000 check made by Thomas Green. The remaining questions relate to the two checks of Houghton, the defendants' president, of $5500 and $10,000, made and accepted by him.

The power given him by the by-law to certify checks clearly did not authorize him to certify *his own checks*. It is a necessary and universal implication, in all cases of agency, that the power conferred upon the agent is to be exercised for the exclusive benefit of the principal. It is repugnant to the very nature and exercise of such power to hold that it may be used for the benefit of the agent in hostility to the interests of the principal. That a trustee or agent shall not act for his own benefit in any matter relating to his agency or trust, is an old and familiar doctrine of the courts of equity, frequently asserted in this country and in England.

The rule is applicable to all persons standing in a trust relation. The principal is entitled to the exercise in his behalf of all the skill and industry and ability of his agent, to his utmost fidelity to his business.

This rule is well stated and discussed in the opinion of Judge DENIO in the case of *The New York Central Insurance Company* vs. *National Protection Insurance Company*, 14 N. Y. 85, and S. C. 20 Barb. 471.

But it is claimed that these rules do not apply in their strictness to negotiable paper; that when there is an apparent authority to execute such paper a *bonâ fide* holder is to be protected, as in the case of partnership paper in the hands of an innocent holder.

These checks were negotiable, and the certificate thereon indorsed by the defendants' president was equivalent in legal effect, if a valid act, to the acceptance of a bill of exchange to the same amount. Judge SELDEN, in the case of *The Farmers' and Mechanics' Bank of Kent Co.* vs. *Butchers' and Drovers' Bank*, 16 N. Y. 128, says of such checks: "Each check, if duly certified, imposes upon the bank an obligation to retain the amount for which the check is drawn, and the obligation assumed is substantially the same as that assumed by the acceptance of an ordinary bill of exchange." Judge DENIO uses very nearly the same language in the same case in 14 N. Y. 625.

These checks, after their acceptance in the manner above stated, were transferred to the plaintiffs for their full face, as the referee finds, and he also finds that he received the same in good faith for value.

This consideration presents all the difficulty in the case. A *bonâ fide* holder of negotiable commercial paper is a favorite of the law, and his rights are always guarded by the courts with great care and liberality, from respect to the great interests of trade and commerce.

But I do not think this consideration can be permitted to prevail, to sustain the plaintiffs' right of recovery in this case upon these two checks.

Clearly upon well settled principles Houghton had no power to accept his own drafts or checks in behalf of the bank. The act was a palpable excess of authority, and any person taking the paper was bound to inquire as to the power of the agent so to contract.

This rule was asserted in the cases of *Starin* vs. *The Town of Genoa*, and *Gould* vs. *The Town of Sterling*,, 23 N. Y. 452 and 464. In these cases the plaintiffs were the *bonâ fide* holders of the bonds in suit, had paid their full value for them; but this court held, that they were bound to inquire as to the facts upon which the authority of the agent depended to issue the bonds. Judge SELDEN says, page 464, "One who takes a negotiable note or bill of exchange purporting to be made by an agent, is bound to inquire as to the power of the agent."

Within that rule the plaintiffs were bound to inquire, whether Houghton had authority to accept his own checks in behalf of the bank, so as to bind the bank on the acceptances. But I do not think the plaintiffs can properly be called *bonâ fide* holders of these checks. The referee finds that they are holders for value, and that they paid the full amount of the face of the checks and took them in good faith. This is all the referee finds on the facts. In finding as a conclusion of law that the defendants are liable on such checks, he may perhaps be deemed to find that they were *bonâ fide* holders thereof within the legal sense of such purchase.

But I think the conclusion of law erroneous, and that the plaintiffs cannot be truly considered in a commercial or legal sense *bonâ fide* holders of these checks. A *bonâ fide* holder of commercial paper must receive the same in the usual course of business for value, and without any notice of facts tending to impeach the character and validity of the paper as between the original parties.

The plaintiffs cannot claim the protection of this rule. They had distinct notice by the form of the certificate and the signature thereto, that the acceptance was improper and irregularly made. It was patent on the face of the paper that the acceptance was a *fraud.* That the president of the defendants' bank in accepting such checks, was using his official character for his personal benefit, and thereby perpetrating an act of dishonesty in palpable violation of his trust. No business man of common intelligence could take these checks in good faith and without suspicion or notice of this fraud. Upon this distinct question I would hold, that the plaintiffs are not *bonâ fide* holders of these checks, and are not entitled to recover the same of the defendants; and the fact also, that these three checks of $20,500, were taken and held for the period of nearly a year after their receipt by the plaintiffs, without presentation to the bank for payment, and that this large amount of money was thus left in the bank to the credit of the drawer of the checks, without interest or any arrangement about it,—unexplained, is quite conclusive evidence that the checks were not taken in the *usual course* of business. But evidence may be given on another trial explanatory of this delay in presenting the checks for payment, which may be quite satisfactory. Evidence on this point was offered, which I think was erroneously excluded by the referee. That this defence, though in its origin and nature of an equitable kind, is now available in an action at law upon the instrument improperly executed by the agent or trustee, is fully asserted and distinctly held in the opinion of Judge DENIO, in the case of *The New York Mutual Insurance Co.* vs. *The Mutual Protection Insurance Co.*, 14 N. Y. 90, *supra*, and is, therefore, *res adjudicata* in this court.

I think the judgment of the court below should be reversed, and a new trial granted, with costs to abide the event.

Judgment reversed.

SELDEN, DENIO, GOULD, and ALLEN, Js., concurred.

I. The first case in which the English Courts found it necessary to pass upon the usage then prevailing with bankers to mark checks as "good," appears to have been Robson and Waugh *vs.* Bennett, 2 Taunton 389 (1810). The head note of that case is as follows:—"By the practice of the London bankers, if one banker who holds a check drawn on another banker presents it after four o'clock, it is not then paid, but a mark is put on it to show that the drawer has assets, and that it will be paid; and checks so marked have a priority, and are exchanged or paid next day at noon at the clearing-house; * * * Held, that such a marking under this practice amounts to an acceptance, payable next day at the clearing-house." The Court said, (MANSFIELD, C. J.): "The effect of that marking is similar to the accepting of a bill; for he (the banker) admits hereby assets, and makes himself liable to pay." In that case the check was marked at the banking-house by one of the partners in the banking firm. Most of the cases which have arisen in this country have concerned the power of agents of corporations to certify checks in like manner. We think where the power is impliedly conferred upon an agent to certify checks, that it can only be exercised at the place of business of the bank. As soon as the check is certified it is in the course of business charged to the account of the drawer as so much money paid to his order, and the check is entered in a new account of certified checks. Such is the practice with the banks in the city of New York, and must in the nature of the case be substantially the same everywhere. This practice evidently could not be adhered to if the certifying officer was allowed to attend to his duties while absent from the bank. This view seems to have received the sanction of the Supreme Judicial Court of Massachusetts: Bullard *vs.* Randall, 1 Gray 607 (1854). SHAW, C. J., says: "Were it the practice of banks to accept checks and thereby bind the bank to their payment, it would be necessary to keep a separate account with the depositor in which all such acceptances should be charged; such acceptance being as effectual a reduction of the deposit as actual payment, making the bank from the time of such acceptance a debtor to the holder, and discharging them as debtor to the drawer: otherwise a bank would never know, on the presentation of a check, whether the drawer had funds to pay it or not. But if it must be presented, accepted, and charged before it can avail the holder, this must necessarily be done at the bank, and the verbal assent of the cashier elsewhere could not avail the holder." In the principal case, it was unnecessary to pass upon this point, as the acceptance was invalid on other grounds. But whenever that question is fairly presented, it is believed that the conclusion will be reached that nothing short of a distinct course of business or express authority will confer upon the certifying agent the power to certify checks, while absent from the bank, in favor of a holder who knew that the check was thus certified.

II. It is now well settled, whenever the certifying officer has acted in the ordinary course of business, and the certified check has passed into the hands of a *bonâ fide* holder for value, the bank cannot show in defence that the drawer had no funds when the check was certified. The reason of this rule is well explained by SELDEN, J., in the case of Gould *vs.* The Town of Sterling, 23 N. Y. 439. See note 1 Am. Law Register, N. S. 291; Farmers' and Mechanics' Bank *vs.* Butchers' and Drovers' Bank, 16 N. Y. 125. The system of certifying checks does not appear to be practised in England. Lord WENSLEYDALE (PARKE, B.) says, in Bellamy *vs.* Marjoribanks, 7 Exch. 404 (1852), that it is a practice "not usual but legal."

III. Some attempt has been made in recent authorities to show that the holder of a check could, without any certificate or acceptance, sue the bank if it refused to pay the check when it had funds of the drawer sufficient to meet it. The only case in which that point is known to have been *decided* is Fogarties *vs.* State Bank, in the Court of Appeals of South Carolina in 1860, 8 Am. Law Register 393. The Court says, with commendable candor, "We do not hear of a right of action on the part of the holder." The reasoning is as novel and unprecedented as the decision. It would be scarcely necessary to notice this case, had it not received the sanction of Mr. Parsons in his recent edition (1862) of "The Elements of Mercantile Law." He says: "But whether the holder of a check in case of refusal may sue the bank for non-payment, is a question of some difficulty, and is not yet settled by authority. But we have no doubt but that, on correct principles of commercial law, the holder should have this right, so long as the bank has funds of the depositor in its possession." P. 91, citing the case already noticed. It is difficult, however, to see *what* principle of the law of commercial paper could be invoked to sustain such an action. Nothing can be more elementary than that a drawee of any ordinary draft or bill of exchange must accept it before the holder can have a right of action against him. If there is any different rule in the case of checks, it must be for special reasons not applicable to other commercial instruments. We have seen nothing bearing the semblance of an argument in favor of the proposition but this. It has now become a settled rule of law with a number of the American Courts, that if A., for a valid consideration, promises B. that he will pay C. a sum of money, C. can maintain an action against A., though a stranger to the consideration. Carnegie *vs.* Morrison, 2 Metcalf 381; Barker *vs.* Bucklin, 2 Denio 45. It is urged that this doctrine can be applied in favor of the holder of a check. The reasoning is, that the bank agrees with the depositor to pay any person whom he may designate by drawing the check in his favor. The reply is that there is no analogy between the cases. In the first class of cases, there is an *express* contract entered into with a person *designated at the time the contract is made*, or an express direction given by the party advancing the consideration, to which the person claimed to be liable has assented. In the case of the check, the contract of the bank with the drawer is implied by law, and no third person is named by the parties. The cases would be precisely parallel if the bank agreed to pay checks drawn in favor of a particular person, which would be tantamount to an acceptance. On the theory of the South Carolina Court, when is the contract with the holder made? When the check is drawn and delivered to the holder? If so, a

bank might be ruined, for as it pays checks in the order of their presentation, the account might have been paid while a prior check was outstanding, of which they had no knowledge, and for the payment of which they were still bound. This view is so absurd that it will not be advanced. Is the contract made by a presentment of the holder for payment? Manifestly not, for then the bank is simply called upon to *fulfil* a duty or obligation which is assumed to have been *previously* incurred. Presentment for payment *ex vi termini* involves the notion of an already existing obligation to pay a debt to the presentor, except where payment is voluntary. Does the contract arise when the bank refuses payment? Then it is believed to be the only case in the law when that which was not a contract before becomes such by a refusal to contract. Clearly then the holder has no remedy against the bank. The authorities and dicta which hold that an acceptance is necessary before the holder can bring his action are, among others, National Bank *vs.* Eliot Bank, 5 Am. Law Register 711, Superior Court, Suffolk Co., Mass.; Ballard *vs.* Randall, 1 Gray 606; Bellamy *vs.* Marjoribanks, 7 Exch. R. 404, per PARKE, B.; Chapman *vs.* White, 2 Selden 412. The text writers on bills and notes uniformly express themselves in the same manner. Without doubt, the bank is liable to the *depositor* for all the damages sustained by its refusal to pay a check which he had a right to draw. Marzetti *vs.* Williams, 1 B. & Ad. 415. No claim can be made by the holder of an uncertified check that it can operate in his favor as an assignment to him of so much money as the check represents. This proposition has been often decided. See the leading case of Dykers *vs.* Leather Manufacturers' Bank, 11 Paige 616.

IV. The proposition in the principal case, that the identity of the name of the drawer of the check and of the president of the bank is sufficient to put the holder on his guard, is sustained by Hatcher *vs.* Rochelcau, 18 N. Y. 86; Jackson *vs.* Goes, 13 Johns. 518, per SPENCER, J.; Jackson *vs.* King, 5 Cow. 237; 9 Id. 140.

RECENT ENGLISH DECISIONS.

Exchequer of Pleas, Nov. 7, 1862.

ARBON AND ANOTHER *vs.* FUSSELL.[1]

An agreement for the hire by defendant from plaintiffs of a pair of carriage-horses for twelve months, the defendant to give three months' notice previous to the expiration of the year of her intention to give up the horses, was prepared in duplicate, and one part signed by plaintiffs was sent by them to defendant by her servant, and the other part signed by defendant was retained by plaintiffs. Defendant having given up the horses without notice, plaintiffs brought an action against her on the agreement. Having lost their part, plaintiffs gave

[1] 7 Law Times, N. S. 283.